

Message Text

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ACTION EB-11

INFO OCT-01 EUR-25 ISO-00 CIAE-00 DODE-00 PM-07 H-03

INR-10 L-03 NSAE-00 NSC-10 PA-04 RSC-01 PRS-01 SPC-03

SS-20 USIA-15 AID-20 COME-00 FRB-02 TRSE-00 XMB-07

OPIC-12 CIEP-02 LAB-06 SIL-01 OMB-01 CEA-02 SCI-06

FEA-02 INT-08 AF-10 NEA-11 IO-14 ACDA-19 AEC-11

AECE-00 STR-08 AGR-20 DRC-01 /277 W
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P R 211655Z JAN 74

FM AMEMBASSY COPENHAGEN

TO SECSTATE WASHDC PRIORITY 8356

INFO USMISSION EC BRUSSELS

AMEMBASSY OSLO

USMISSION OECD PARIS

AMEMBASSY STOCKHOLM

C O N F I D E N T I A L SECTION 1 OF 2 COPENHAGEN 0184

E.O. 11652: GDS

TAGS: EFIN, ECON, ENRG, OECD, DA

SUBJ: T/IEP: FEBRUARY 11 FOREIGN MINISTERS

MEETING ON INTERNATIONAL ENERGY PROBLEMS:

DENMARK'S ECONOMIC OUTLOOK

REF: STATE 7324

BEGIN SUMMARY: DENMARK MUST IMPORT ALMOST
ALL OF ITS ENERGY SOURCE MATERIALS, AND OIL
HAS NORMALLY COMPRISED 90 PERCENT OF THIS
AMOUNT. IT HAS THEREFORE BEEN HARDER HIT
THAN OTHER EUROPEAN COUNTRIES BY THE CURRENT
OIL CRISIS. IT HAS TAKEN EARLIER, AND MORE
STRINGENT, MEASURES THAN OTHER EUROPEAN COUN-
TRIES IN RESTRICTING OIL USE. HAVING FOR
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MANY YEARS HAD LARGE BALANCE OF PAYMENTS

DEFICITS, THE SHARPLY INCREASED DEFICIT EXPECTED THIS YEAR WILL BE DIFFICULT TO FINANCE. FARM EXPORTS WILL BE MAINTAINED AND INDUSTRY HOPES TO EXPAND MANUFACTURED EXPORTS; HOWEVER, THIS WILL DEPEND ON DEMAND CONDITIONS IN FOREIGN MARKETS. DOMESTIC CONSUMPTION WILL BE DOWN, INFLATION FURTHER INCREASED AND UNEMPLOYMENT WILL RISE SOMEWHAT. DESPITE EXTERNAL DEFICITS, ECONOMY IS BASICALLY HEALTHY AND HAS BEEN OPERATING AT VERY HIGH LEVEL OF ACTIVITY. SOME GIVE IS THEREFORE POSSIBLE WITHOUT EXCESSIVE DAMAGE. MOREOVER, FOREIGN EXCHANGE RESERVES STAND AT RELATIVELY COMFORTABLE LEVEL OF \$1.3 BILLION, PERMITTING SOME DRAWDOWNS TO CUSHION ADJUSTMENTS TO NEW CONDITIONS OF HIGHER FUEL COSTS. END SUMMARY.

1. FORECAST IS BASED ON OFFICIAL GOVERNMENT PROJECTIONS SUBMITTED TO PARLIAMENT LAST WEEK, VIEWS OF LEADING GOVERNMENT AND INDUSTRY ECONOMISTS, ACADEMICIANS AND OTHER PROMINENT PUBLIC FIGURES. EMBASSY HAS ATTEMPTED TO BALANCE OUT VARIOUS VIEWS WITH ITS OWN JUDGMENT ON PROSPECTS FOR 1974. NOTE THAT ALL DOLLAR CONVERSIONS ARE AT OFFICIAL PARITY OF DKR 6.28 TO \$1.00.

2. GROWTH RATE. OFFICIAL ESTIMATES PREDICTING A 3.25 PERCENT GNP GROWTH FOR 1974 HAVE NOW BEEN REVISED DOWNWARD TO 2-2.5 PERCENT AS RESULT OF HIGHER ENERGY AND OTHER RAW MATERIAL COSTS AND THEIR ANTICIPATED EFFECTS ON BOTH THE DANISH ECONOMY AND PRINCIPAL DANISH EXPORT MARKETS. EMBASSY BELIEVES GROWTH IS LIKELY TO BE IN 1.5-2 PERCENT RANGE; OTHERS ARE MORE PESSIMISTIC.

3. MAJOR DOMESTIC ECONOMIC TRENDS. VARIED FACTORS LEADING TO EXPECTATIONS OF REDUCED GROWTH ARE ACCELERATED RATE OF INFLATION, CONFIDENTIAL

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REDUCED DOMESTIC CONSUMPTION, CONTINUING HIGH LEVELS OF AGRICULTURAL OUTPUT BUT SOME DAMPENING OF INCREASE IN INDUSTRIAL PRODUCTION AND, MODERATE INCREASE IN UNEMPLOYMENT.

A. INFLATION RATE IS LIKELY TO RISE FROM PRESENT 11 PERCENT TO 15 PERCENT OR MORE; WAGES ARE LIKELY TO GO UP EVEN HIGHER PARTI-

CULARLY IF PRESENT GOVERNMENT EFFORTS TO CHANGE EXISTING SYSTEM FOR AUTOMATIC COST OF LIVING INCREASES ARE UNSUCCESSFUL. THEREFORE, GNP DEFLATOR IS NOT LIKELY TO BE LESS THAN 15 PERCENT. IF GOVERNMENT-PROPOSED RESTRAINT MEASURES ARE ADOPTED, DEFLATOR OF 10-11 PERCENT MIGHT BE ANTICIPATED.

B. CONSUMER DEMAND WILL GROW CONSIDERABLY LESS THAN 4 PERCENT PREVIOUSLY ESTIMATED BUT PROBABLY SOMEWHAT MORE THAN THE REVISED GOVERNMENT ESTIMATE OF 0-0.1 PERCENT GROWTH. GROSS INCOMES WILL RISE LESS THAN IN 1973 BECAUSE FARMERS WILL NOT HAVE A REPEAT OF WINDFALLS RECEIVED LAST YEAR AS DENMARK ADJUSTED TO THE COMMUNITY CAP SYSTEM; INDUSTRIAL WORKERS MAY HAVE SOME REDUCTION IN OVERTIME PAYMENTS (COMPENSATED, AT LEAST IN PART, BY WAGE INCREASES), AND UNEMPLOYED WILL INCREASE (ALTHOUGH THESE WOULD BE COMPENSATED BY UNEMPLOYMENT PAYMENTS OF 90 PERCENT OF BASE WAGES). THE SHARP PRICE RISES EXPECTED WILL REDUCE WHATEVER NOMINAL INCOME GAINS ACHIEVED AND, THEREFORE, EMBASSY ESTIMATES CONSUMER DEMAND IS NOT LIKELY TO RISE ABOVE 2 PERCENT AND THEN ONLY AT COST OF SOME REDUCTION IN CURRENT RELATIVELY HIGH RATE OF SAVINGS.

C. PUBLIC SECTOR DEMAND, WHICH HAS ACCELERATED RAPIDLY IN RECENT YEARS, IS LIELY TO FLATTEN SOMEWHAT IF GOVERNMENT SUCCEEDS IN OBTAINING SOME PART OF ITS PROPOSED AUSTERITY BUDGET FOR NEW FISCAL YEAR STARTING APRIL 1. WHILE ISSUE IS POLITICALLY DIFFICULT IN HIGHLY FRANCHONALIZED PARLIAMENT, THERE APPEARS TO BE BROAD CONSENSUS THAT SOMETHING MUST BE DONE TO REDUCE PUBLIC

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SECTOR OUTLAYS. ON OTHER HAND, SHOULD UNEMPLOYMENT RISE SIGNIFICANTLY, PRESSURES WILL BE STRONG TO INCREASE PUBLIC WORKS.

D. AGRICULTURE SHOULD BE ONLY marginally AFFECTED BY FUEL SHORTAGES AND HIGHER PRICES FOR INPUTS SINCE BOTH DEMAND (DOMESTIC AND FOREIGN) AND RISING FOOD PRICES ARE LIKELY TO CONTINUE, ALTHOUGH THE LATTER AT MORE MODEST LEVELS THAN LAST YEAR.

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E. MANUFACTURING INDUSTRY WAS PLAGUED LAST YEAR BY STRIKES, INSUFFICIENT CAPACITY AND MAN-POWER SHORTAGES. REDUCED GROWTH IN DOMESTIC DEMAND AND SOME EASING OF LABOR SHORTAGES SHOULD MAKE INDUSTRY BETTER ABLE TO EXPLOIT EXPORT MARKETS PROVIDED, OF COURSE, THAT FOREIGN DEMAND IS NOT SHARPLY CURTAILED FROM EFFECTS ENERGY SITUATION. SINCE PRINCIPAL DANISH EXPORTS ARE HIGHLY SPECIALIZED, OFTEN INTERMEDIATE, PRODUCTS, AND DANISH INDUSTRY HAS SHOWN ITS VERSATILITY IN ADAPTING ITSELF TO FOREIGN DEMAND CONDITIONS, IT MAY FIND ADJUSTMENT TO THE CHANGING PATTERNS EASIER THAN COUNTRIES WITH LARGE HEAVY INDUSTRY SECTORS. GOVERNMENT OFFICIALS BELIEVE THAT, SHOULD OIL SHORTAGES CONTINUE TO BE PROBLEM, ADEQUATE SUPPLIES CAN BE ASSURED TO INDUSTRY.

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TRY BY MAINTAINING OR, IF NECESSARY, INCREASING RESTRICTIONS ON PRIVATE CONSUMPTION. NONETHELESS, INDUSTRY SOURCES CONTINUE TO BE CONCERNED ABOUT SUPPLY AND, IN PARTICULAR, ABOUT RISING FUEL AND OTHER RAW MATERIAL COSTS. WHILE THESE WILL NOT NECESSARILY AFFECT THEIR COMPETITIVE POSITION, SINCE EVERYONE ELSE IS FACED WITH SIMILAR PRICE INCREASES, DAMPENING EFFECT OF PRICE INCREASES ON BOTH DOMESTIC AND EXPORT MARKETS WILL MAKE THIS A DIFFICULT YEAR TO IMPROVE SALES.

F. UNEMPLOYMENT IN RECENT YEARS HAS BEEN PRACTICALLY NON-EXISTENT. IN US TERMS, IT HAS BEEN A LITTLE OVER ONE PERCENT. THIS YEAR'S SLOWER GROWTH RATE SHOULD HAVE LIMITED EFFECT ON EMPLOYMENT, GIVEN SMALL INFLOW OF NEW LABOR INTO THE MARKET AND PROBABLY SOME CONTINUING ABSORPTION OF LABOR INTO PUBLIC SECTOR DESPITE EFFORTS AT BUDGETARY AUSTERITY. OFFICIAL ESTIMATES FORECAST, AT WORST, A DOUBLING OF UNEMPLOYMENT TO ABOUT 2.5 PERCENT OF ALL WORKERS. THIS SHOULD CAUSE NO SERIOUS DISLOCATIONS.

4. BALANCE OF PAYMENTS. TRADE AND PAYMENTS BALANCES WILL THIS YEAR BE AFFECTED BY (A) HIGHER OIL PRICES, (B) DEFERRED EFFECTS OF ALREADY REGISTERED PRICES ON OTHER RAW MATERIALS, (C) SOME CONTINUATION OF GAINS IN DANISH INDUSTRIAL EXPORTS IN BOTH QUANTITIES AND PRICES, (D) FLATTENING OF EXPORT GAINS FOR AGRICULTURAL PRODUCTS, AND (E) MORE MODERATE IMPORT GROWTH COMPARED TO SHARP RISE LAST YEAR. DENMARK HAD A 1973 CURRENT ACCOUNT DEFICIT OF AROUND DKR 3 BILLION (\$478 MILLION); 1974 DEFICIT WAS INITIALLY ESTIMATED AT ABOUT DKR 4 BILLION (\$637 MILLION) AND SUBSEQUENTLY ADDITIONAL FUEL COSTS WERE ESTIMATED AT ANOTHER DKR 4 BILLION GIVING A RAW ESTIMATE OF DKR 8 BILLION (\$1.3 BILLION) DEFICIT, AN IMPROBABLE EVENT. CONSIDERING NET EFFECTS OF REDUCED DOMESTIC DEMAND, DECLINE AND SUBSTITUTIONS IN FUEL USES, AND STRUCTURAL ADJUSTMENTS IN THE ECONOMY, MOST REASONABLE ESTIMATE OF CURRENT

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RENT ACCOUNT DEFICIT FOR 1974 IS DKR 6.5 BILLION (\$1 BILLION), STILL A DISCONCERTINGLY HIGH FIGURE, GIVEN THE ACCUMULATION OF LARGE DEFICITS IN THE PAST AND HEAVY FOREIGN BORROWING DENMARK HAS ALREADY DONE TO FINANCE THEM. FINANCING OF DEFICIT WILL BE PROBLEM IN TIGHTER INTERNATIONAL LOAN MARKET, BUT DANES HAVE CUSHION OF FAIRLY COMFORT-

ABLE CURRENT FOREIGN EXCHANGE RESERVES OF ABOUT
DKR 8 BILLION (\$1.3 BILLION).

5. MONETARY AND FISCAL POLICIES. OVER THE PAST
DECADE, MONETARY POLICY HAS GENERALLY BEEN TIGHT
IN EFFORT TO CONTROL INFLATION. SHARPLY RISING
BALANCE OF PAYMENTS DEFICIT THIS YEAR WILL HAVE
RESTRICTIVE EFFECT ON DOMESTIC MONEY MARKETS;
THEREFORE MONETARY AUTHORITIES ARE INCLINED TO-
WARD CAUTION IN ANY FURTHER TIGHTENING. SEVERAL
DANISH ECONOMISTS HAVE IN FACT URGED EXPANSION-
ARY POLICIES. ON FISCAL SIDE, EMPHASIS IS CUR-
RENTLY ON BUDGETARY AUSTERITY AND RELATIVELY
TIGHT BUDGET IS LIKELY. IN SUM, MONETARY POLICY
WILL PROBABLY BE NEUTRAL TO SLIGHTLY EXPANSIONARY
WHILE FISCAL POLICY WILL BE TIGHT, LEAVING ROOM
FOR EXPANSION SHOULD CIRCUMSTANCES (E.G., RISING
UNEMPLOYMENT) WARRANT.

6. GENERAL TRADE POLICY. DENMARK'S TRADITIONAL
COMMITMENT TO FREE TRADE, WITH EXCEPTION OF AGRI-
CULTURE NOW THAT IT IS UNDER CAP, REMAINS FIRM.
SPECIAL CIRCUMSTANCES BROUGHT ON BY ENERGY CRISIS
LED TO IMPOSITION LAST OCTOBER OF LICENSING REQUIRE-
MENT ON ALL EXPORTS OF OIL AND ITS PRODUCTS BUT
THIS MOVE IS INTENDED PRINCIPALLY AS CHECK ON OIL
EXPORTS LARGER THAN NORMAL. NO OTHER CONTROLS
ARE PRESENTLY CONTEMPLATED.

7. NEAR TERM EFFECTS OF OIL CRISIS. WHILE FOURTH
QUARTER 1973 STATISTICS ARE NOT YET COMPLETE,
UNOFFICIAL REPORTS INDICATE DECEMBER TRADE BALANCE
WILL BE MORE FAVORABLE THAN EXPECTED. BECAUSE
OF LARGE INVENTORY BUILDUPS EARLIER IN YEAR, HIGHER
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RAW MATERIAL PRICES (OTHER THAN OIL) WILL NOT
BE REFLECTED UNTIL RESTOCKING THIS YEAR. FOR
OIL ALSO, ADVERSE PRICE EFFECTS WILL BEGIN TO SHOW
IN FIRST QUARTER 1974 AND THIS WHOLE PERIOD IS
LIKELY TO BE ONE OF CONSIDERABLE READJUSTMENTS
TO MUCH HIGHER FUEL PRICES. ELECTRIC POWER INDUS-
TRY HAS, IN PAST FEW MONTHS, SHIFTED FROM 80:20
OIL/COAL CONSUMPTION RATIO TO 50:50 AND IS APA-
BLE OF FURTHER REDUCING RATIO TO 30:70. OTHER
INDUSTRIES (E.G., CEMENT) ARE ALSO SHIFTING TO
COAL WHERE POSSIBLE. HOWEVER, MAJOR COAL SOURCE,
POLAND, HAS BEEN RENEGOTIATING CONTRACTS AND,
REPORTEDLY, INCREASED PRICES THREEFOLD. WHILE
SOME STRUCTURAL ADJUSTMENTS IN ECONOMY ARE LIKELY

BECAUSE OF CHANGING COST FACTORS, THEY ARE NOT
LIKELY TO BE LARGE OR EXCESSIVELY DISRUPTIVE SINCE
DENMARK'S INDUSTRY IS TYPICALLY SMALL AND CAPA-
BALE OF SHIFTING PRODUCTION MORE EASILY THAN HEAVY
INDUSTRY ELSEWHERE.
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